

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 NSAE-00 NSCE-00 SSO-00
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TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01 LAB-04 SIL-01
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FM AMEMBASSY LISBON
TO SECSTATE WASHDC IMMEDIATE 9604

S E C R E T SECTION 1 OF 2 LISBON 8769

DEPT. PASS TREASURY FOR YEO, SYVRUD AND WILLIS, WHITE HOUSE
FOR GEN. SCOWCROFT

E.O. 11652: XGDS-3
TAGS: EFIN, EAID, PO
SUBJECT: FINANCIAL ASSISTANCE PROGRAM FOR PORTUGAL

BEGIN SUMMARY. GOP FOREIGN EXCHANGE RESERVES HAVE REACHED
LOWEST LEVEL IN RECENT HISTORY. USG SHORT-TERM LOAN IS
URGENT IF DRASTIC AND DISRUPTIVE MEASURES ARE TO BE AVOIDED.
GOP TELLS US IT IS WILLING TO MAKE BINDING COMMITMENT IN
ADVANCE TO SELL GOLD FOR REPAYMENT PURPOSES. USG FLEXIBILITY
ON THIS ISSUE COULD MAKE THE DIFFERENCE BETWEEN RELATIVE
POLITICAL STABILITY AND A RETURN TO TURMOIL. END SUMMARY.

1. AT MY INSTRUCTIONS ECONOMIC COUNSELOR CALLED ON DR. LOBO
VILELA (THE LAWYER WHO ACCOMPANIED FINANCE MINISTER TO
WASHINGTON) MORNING OF DECEMBER 21 TO REVIEW LAST WEEK'S
DISCUSSIONS IN WASHINGTON ON REF SUBJECT. LATER THAT SAME
DAY HE MET WITH BOTH LOBO VILELA AND SILVA LOPES, AT
LATTER'S REQUEST. GOP OFFICIALS CLEARLY WERE DISTRAUGHT
AS THEY DESCRIBED BANK OF PORTUGAL'S (BOP) RESERVE POSITION.
BOP LOST \$60 MILLION DURING FIRST TWENTY DAYS OF
DECEMBER, \$20 MILLION ON DECEMBER 20 ALONE. ITS FOREIGN
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RESERVES ON THAT DATE WERE DOWN TO \$79 MILLION, THE LOWEST
LEVEL IN RECENT HISTORY. IT STILL CAN DRAW DOWN \$85
MILLION FROM REMAINDER OF EUROPEAN CENTRAL BANK AND
RECENT EUROPEAN COMMERCIAL BANK CONSORTIUM LOANS, WHICH
WOULD RAISE TOTAL OF AVAILABLE RESERVES TO \$164 MILLION.
GOP NEGOTIATING FOR TWO ADDITIONAL CREDITS, BUT THESE

WOULD AMOUNT TO ONLY \$85 MILLION - IF THEY ARE CONCLUDED. FORMAL DISCUSSIONS WITH IMF ON FIRST CREDIT TRANCHE DRAWING BEGIN JANUARY 6, EVEN THOUGH GOP REALIZES THAT FUND WILL IMPOSE UNUSUALLY SEVERE CONDITIONS. ON THE OTHER HAND, LARGE SHORT-TERM TRADE CREDITS CONTRACTED IN MID-1976 WILL MATURE DURING NEXT SIX WEEKS AND CAUSE VERY HEAVY RESERVE LOSSES. IF ADDITIONAL LIQUIDITY IS NOT OBTAINED SOON, PORTUGUESE OFFICIALS STATED, PORTUGAL WILL HAVE TO ADOPT FURTHER EXCHANGE RESTRICTIONS IN ORDER TO AVOID EXHAUSTION OF ITS RESERVES AND VIRTUAL COLLAPSE OF ITS ECONOMY.

2. DESPITE THIS DISASTROUS PROSPECT, THEY AFFIRMED, PORTUGAL CANNOT ACCEPT AN ESF LOAN IN THE FORM OF A GOLD SWAP. SUCH A SWAP, THEY INSISTED, WOULD WORSEN RATHER THAN IMPROVE SITUATION. PRIVATE BANKS ARE STILL WILLING TO EXTEND PORTUGAL SHORT-TERM CREDITS ONLY BECAUSE OF THE NATION'S REMAINING UNCOMMITTED GOLD STOCK. IF PORTUGAL BEGINS SELLING GOLD, EVEN IF IT IS U.S. GOLD, PRIVATE BANKS WOULD NOT ONLY REFUSE TO CONSIDER ANY NEW TERM LENDING, BUT WOULD REDUCE SHARPLY THEIR EXISTING CREDIT LINES, JUST AS THEY DID IN 1974 AND 1975. THIS REDUCTION COULD EASILY EXCEED THE AMOUNT OF AN ESF LOAN. IF, ON THE OTHER HAND, GOLD SALES WERE DELAYED UNTIL AFTER THE CONCLUSION OF A USG-LED CONSORTIUM LOAN, POSSIBILITY OF A SIGNIFICANT NEGATIVE REACTION FROM PRIVATE BANKING CIRCLES WOULD BE NEGLIGIBLE.

3. PORTUGUESE OFFICIALS INSISTED THAT THEY DO NOT
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OPPOSE, IN PRINCIPLE, GOLD SALES. RATHER, THEY ARE CONCERNED ABOUT THE TIMING OF SUCH SALES. THEY WOULD, FOR EXAMPLE, BE PREPARED TO SUPPORT A SCHEME ALONG THE FOLLOWING LINES. AT SAME TIME THAT ESF LOAN IS SIGNED, PORTUGAL WOULD SIMULTANEOUSLY:

A. CONSTITUTE A GOLD DEPOSIT WITH THE NEW YORK FED OR THE BIS IN AN AMOUNT THAT CLEARLY EXCEEDS THE ESF LOAN;

B. PLEDGE NOT TO DIMINISH NOR TO IMPAIR ITS OWNERSHIP OF THAT GOLD DURING THE TERM OF THE LOAN; AND

C. AUTHORIZE THE NEW YORK FED, THE BIS OR ANOTHER MUTUALLY ACCEPTABLE INSTITUTION TO SELL, OVER A SIX MONTH PERIOD BEGINNING SIX MONTHS FROM THE DATE OF THE LOAN, AN AMOUNT OF THE DEPOSITED GOLD SUFFICIENT TO REPAY THE CREDIT. IN THIS MANNER USG WOULD ATTAIN COMPLETE GUARANTEE OF REPAYMENT AND GOP WOULD DELAY GOLD SALES UNTIL LARGE CONSORTIUM LOAN IS CONCLUDED. PORTUGUESE OFFICIALS SUBSEQUENTLY CONSULTED WITH FINANCE

MINISTER MEDINA CARREIRA. LATTER ACCEPTED PROPOSAL, IN PRINCIPLE, AS A VALID BASIS FOR FURTHER NEGOTIATIONS, BUT NOTED THAT HE HAS NOT HAD OPPORTUNITY TO DISCUSS IT WITH PRIME MINISTER SOARES.

4. COMMENT: THE UNDERLYING RATIONALE FOR THE LOAN PROGRAM IS TO STRENGTHEN PRO-WESTERN ELEMENTS AND CONSOLIDATE DEMOCRACY IN PORTUGAL. THE SEQUENCE OF EVENTS IS SUCH, HOWEVER, THAT A LACK OF FLEXIBILITY ON THE GOLD ISSUE COULD PRODUCE PRECISELY THE OPPOSITE RESULT.

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S E C R E T SECTION 2 OF 2 LISBON 8769

DEPT. PASS TREASURY FOR YEO, SYVRUD AND WILLIS, WHITE HOUSE
FOR GEN. SCOWCROFT

5. THE PREMATURE LEAKS ON THE LOAN OCCURED BEFORE THE GOP WAS GIVEN A CHANCE TO EXPLAIN FULLY THE UNACCEPTABLE POLITICAL RISKS INVOLVED IN THE GOLD SWAP. INDEED THEY OCCURRED EVEN BEFORE OUR OFFICIAL PRESENTATION OF THE PROGRAM. THE RESULT HAS BEEN TO CONFRONT THE GOP WITH A PUBLIC POLITICAL DILEMMA IN WHICH ITS OPTIONS ARE: (A) TO ACCEPT A LOAN ACCOMPANIED BY A PROCEDURE WHICH WOULD PARK SUBSTANTIAL POLITICAL AND SOCIAL UNREST, OR (B) TO REJECT IT IN ITS ENTIRETY AND WORSEN THE ECONOMIC CRISIS. SINCE THE WORLD HAS BEEN GIVEN TO UNDERSTAND THAT THE \$300 MILLION IS ALREADY AN ACCOMPLISHED FACT, THE LATTER OPTION COULD ONLY BE MISCONSTRUED AS A WITHDRAWAL OF WESTERN POLITICAL SUPPORT. IN THE SHORT RUN, THIS WOULD SPELL THE END OF THE SOCIALIST GOVERNMENT AND, IN THE MEDIUM

RUN, PROBABLY THE END OF WESTERN STYLE DEMOCRACY AS WELL. THE U.S. WOULD INEVITABLY BE BLAMED.

6. TIMING IS URGENT. THE GOP'S NEGOTIATIONS WITH THE PRIVATE SECTOR ARE STALLED. FOREIGN EXCHANGE RESERVES ARE NEARING THE CRISIS POINT. IT IS DOUBTFUL THE GOP
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CAN GET BEYOND JANUARY WITHOUT TAKING DRASTIC AND DISRUPTIVE ACTIONS TO CURB IMPORTS AND TRANSFER PAYMENTS, ACTIONS WHICH WILL UNDERMINE THE ENTIRE ECONOMIC PROGRAM AND HAVE SEVERED POLITICAL REPERCUSSIONS.

7. STRIPPING AWAY THE TECHNICAL JARGON, WHAT WE ARE REALLY DISCUSSING IS WHEN THE GOP WILL BE REQUIRED TO SELL GOLD, WHETHER IT IS TO BE IN JANUARY OR LATER, WHEN BOTH ECONOMIC AND POLITICAL CONDITIONS WILL BE MORE PROPITIOUS. THE PROPOSAL PRESENTED IN THIS TELEGRAM GIVES ASSURANCE THAT GOP WILL SELL GOLD TO REPAY US. THE FINANCIAL RISKS FOR US ARE THEREFORE MINIMAL; THE POLITICAL RISKS OF REJECTING IT OR SOMETHING SIMILAR ARE ENORMOUS. IT IS NO EXAGGERATION TO SAY THAT THE PROGRESS MADE IN PORTUGAL OVER THE LAST YEAR AND A HALF HANGS IN THE BALANCE.
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